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CHARLES ELMORE CROPLEY
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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. **237**

R. K. JAPHA, suing on his own behalf and on behalf
of all other owners of First and Refunding Mortgage
Gold Bonds, Series A, due January 1, 1951, of Chicago,
Aurora & Elgin Railroad Company,

Petitioner,

vs.

PUBLIC SERVICE COMPANY OF NORTHERN
ILLINOIS, a corporation, and CITY NATIONAL BANK
& TRUST COMPANY OF CHICAGO, a national banking
association,

Respondents.

**Petition for Writ of Certiorari to the United States
Circuit Court of Appeals for the Seventh Circuit and
Motion to Dispense with Printing and Service of
Portions of the Record**

IRVING L. SCHANZER,
Counsel for R. K. Japha, Petitioner.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No.

R. K. JAPHA, suing on his own behalf and on behalf of all other owners of First and Refunding Mortgage Gold Bonds, Series A, due January 1, 1951, of Chicago, Aurora & Elgin Railroad Company,

Petitioner,

vs.

PUBLIC SERVICE COMPANY OF NORTHERN ILLINOIS, a corporation, and CITY NATIONAL BANK & TRUST COMPANY OF CHICAGO, a national banking association,

Respondents.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit and Motion to Dispense with Printing and Service of Portions of the Record

To The Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, R. K. Japha, respectfully submits this, his petition for a writ of certiorari to review the decision and order of the United States Circuit Court of Appeals for the Seventh Circuit in the above cause affirming the order of the District Court for the Northern District of

Illinois, Eastern Division, which dismissed his action against the defendant Public Service Company of Northern Illinois.

Statement

The petitioner instituted the above cause as a representative suit on behalf of all holders of certain bonds (R.* 3, 10), secured by a mortgage to a trustee (R. 4-6), of Chicago, Aurora and Elgin Railroad Company (herein called "Railroad Company"), against Public Service Company of Northern Illinois (herein called "Electric Company"), the lessee of the Railroad Company's electric generating plant, transmission lines and substations, which were part of the mortgaged property (R. 10, 11; P. R. 149).

The mortgage securing the bonds is held by the defendant City National Bank & Trust Company of Chicago as successor trustee (R. 7). Upon its refusal to bring this action after demand, it was joined herein as a formal party (R. 14).

The petitioner sought a decree against the Electric Company for an accounting, for the benefit of all the bondholders, for the depreciation in value of the mortgaged property, which had been leased to the Electric Company, on two separate grounds:

1. the Electric Company violated a covenant of the lease by which it agreed to maintain and operate the said generating plant, transmission lines and substations, and the equipment therein,

* The record consists of a printed Transcript of Record and a certified photostat copy of certain papers, the printing of which was dispensed with by the Circuit Court of Appeals. References herein made to the printed record are made as "R. . ."; to the photostat copy of papers as "P.R. . ."

and to install certain new and substituted equipment (R. 12, 13); and

2. the Electric Company committed and permitted waste of the leased property (R. 13).

The Railroad Company has been in equity receivership of the District Court since 1932, the receivership having been ordered in a suit (No. 12125) instituted by a creditor other than the mortgagee. The trustee of the mortgage commenced foreclosure proceedings (No. 15893) against the Railroad Company alone in December, 1937 (P. R.* 184), and such proceedings were thereafter consolidated with the receivership proceedings.

Pursuant to an order of the District Court made on December 18, 1933, the receiver of the Railroad Company affirmed the lease of the said part of the mortgaged property to the Electric Company (P. R. 16).

On motion of the Electric Company herein, and without a trial, the petitioner's complaint was dismissed by the District Court (R. 28). Your petitioner's appeal from the order of dismissal having been submitted on briefs on his behalf, without oral argument, and the appellee having submitted briefs and made an oral argument, the order was affirmed from the bench by the Circuit Court of Appeals (R. 62).

Opinions Below

Neither the District Court nor the Circuit Court of Appeals rendered any opinion in this cause, and their respective orders (R. 28, 62) are not reported.

*The photostat record contains documents the pages of which were not consecutively numbered. Petitioner has numbered the pages of the certified copy submitted herewith, and the references are to the numbers which have been added in ink.

Jurisdiction of this Court

The order of the Circuit Court of Appeals was made and entered on May 11, 1943 (R. 62). The jurisdiction of this Court is invoked under Section 240a of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A., Sec. 347-a).

The Questions Presented

Because of the absence of any opinion in either of the courts below, the questions presented are determined by the arguments of the defendant Electric Company in the Circuit Court of Appeals. These questions are:

1. Whether a mortgagee* may maintain an action for an accounting against the lessee of the mortgaged property for waste.
2. Whether a mortgagee may maintain an action, as third party beneficiary, against the lessee for breach of covenant to maintain and operate the mortgaged property.
3. Whether the adoption of the lease by a federal equity receiver of the mortgagor, appointed in a contract creditor's suit, bars any suit by the mortgagee against the lessee based on its waste of the property or its breach of covenant to maintain and operate said property without regard to whether the acts complained of occurred before or after the said adoption of the lease.

* In the Circuit Court of Appeals no question was raised by the Electric Company as to the petitioner's capacity to sue, representing all bondholders, who are, as a class, the *cestuis que trustent* of the mortgage, after the trustee's rejection of his demand that it bring the action. The matter was argued on the basis of the bondholders constituting the mortgagee of the property. For the purpose of clarity petitioner is herein called the "mortgagee".

Specification of Errors

The Circuit Court of Appeals erred,

1. in affirming the summary dismissal of the petitioner's complaint against the Electric Company;
2. in failing to hold that the mortgagee could maintain this action for an accounting against the lessee for waste of the mortgaged property;
3. in failing to hold that the mortgagee could maintain this action, as third party beneficiary, against the lessee for breach of its covenant to maintain and operate the mortgaged property;
4. in failing to hold that the adoption of the lease by the mortgagor's equity receiver did not bar the mortgagee's right to sue the lessee for waste of the mortgaged property and for breach of its covenant to maintain and operate the mortgaged property.

Reasons Relied on for Allowance of the Writ

The issue of mortgage bonds involved in this action was originally in the amount of \$5,000,000 (R. 8), of which \$4,850,000 is presently outstanding (R. 9). The mortgagor has been in default in the payment of interest since July 1, 1932 (R. 9).

The decision of the Circuit Court of Appeals is in conflict with the local law of Illinois, decisions of other Circuit Courts of Appeal, and decisions of this Court in the following respects:

1. In failing to uphold the right of the mortgagee to sue the lessee of the mortgaged property for waste it is in direct conflict with

Nelson v. Pinegar, 30 Ill. 473;

Minneapolis Trust Co. v. Verhulst, 74 Ill. App. 350;

Citizens National Bank v. Joseph Kest & Sons Co., 378 Ill. 428.

It is further in conflict with the proposition, recognized in Illinois, that a mortgagee has a legal interest in the mortgaged property, entitling him to maintain actions based on legal title (*Dorr v. Dudderar*, 88 Ill. 107).

It conflicts with the rule obtaining in Illinois that, after default, the mortgagee is the legal owner of the property.

Tuttle v. Harris, 297 U. S. 225;

Wolkenstein v. Slonim, 355 Ill. 306.

The decision of the Circuit Court of Appeals herein is also directly contrary to its own decision in *Hummer v. R. C. Huffman Construction Co.*, 63 F. (2d) 372, which cites with approval the decision in *Delano v. Smith*, 206 Mass. 365. In the *Hummer* case the Circuit Court of Appeals confirmed that an Illinois mortgagee has a legal title sufficient to maintain actions based on title, and upheld a mortgagee's right to sue a third party for waste. In the *Delano* case, the Massachusetts court upheld a mortgagee's right to sue the lessee of mortgaged property for waste arising out of the manner of use of the property by the lessee.

2. In failing to uphold the right of the mortgagee to sue as the third party beneficiary of the lessee's covenant to maintain and operate the mortgaged property, the decision of the Circuit Court of Appeals herein is in conflict with the rule, obtaining in Illinois, which permits third party beneficiaries to sue the covenantor.

Carson Pirie Scott & Co. v. Parrett, 346 Ill. 252;

Fleming v. Dillon, 370 Ill. 325;

Eddy v. Roberts, 17 Ill. 505;

Appeal of Willing v. Continental Illinois Nat'l Bank, 300 Ill. App. 127.

The right of a third party beneficiary to sue had previously been recognized by the same Circuit Court of Appeals in *In re Wolf Manufacturing Industries*, 56 F. (2d) 64.

In connection with this aspect of the cause, the Court should be apprised of the fact that the Electric Company correctly argued below that, if the promise relied upon by the third party beneficiary was not intended to benefit such third party, he could not sue. It incorrectly argued, however, that to constitute an intent to benefit the third party the promise had to be one to perform acts in addition to those which the promisee was under a duty (to the third party beneficiary) to perform. Whether the court below adopted that erroneous argument cannot be known, in the absence of any opinion by that court. If it did, the decision conflicts with the Illinois cases cited above. As to the question of intent to benefit the mortgagee, the covenant involved would appear to be clear. It expressly refers to the mortgagee bondholders and clearly

indicates that they are intended to be protected thereby.* In any event a summary dismissal of such a suit is unwarranted in view of the rule in Illinois that the question of intent to benefit the third party "is to be gleaned from a consideration of all of the contract and the circumstances surrounding the parties at the time of its execution" (*Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, at 258).

3. In failing to hold that the adoption of the lease by the mortgagor's receiver did not bar the mortgagee's right to sue either for waste or, as a third party beneficiary, for breach of the covenant to maintain and operate, the Circuit Court of Appeals was in error. Since one's rights can be affected by prior judicial proceedings only if he was a party, or represented therein, this holding is necessarily based on the theory that the receiver represented the mortgagee, and his affirmance of the lease forecloses the mortgagee from maintaining such suits.

The decision of the Circuit Court of Appeals is in conflict with the fundamental theory that a federal equity receiver is merely a custodian.

Quincy M. and P. R. R. Co. v. Humphreys, 145
U. S. 82, 97;

Union Bank of Chicago v. Kansas City Bank, 136
U. S. 223, 236;

* The covenant reads:

"The Electric Company shall maintain and operate the premises and equipment leased and install and operate any necessary new and/or substituted equipment at its own expense and eventually and at any time make such substitution of equipment as may be necessary to supply electrical energy at 60 cycles instead of the present 25 cycles, with the understanding, however, that the Electric Company shall have the right to discontinue the use of and dispose of any equipment no longer required for the supply of electrical energy to the railroad company, but in so doing shall have in mind and be bound at all times by the prior rights of security holders under both present and future mortgages of the Railroad Company" (R. 12).

Powell v. Maryland Trust Co., 125 F. (2d) 260, 271 (C.C.A. 4th).

It is in conflict with the rule that such a receiver has no greater rights or powers than the corporation of which he is receiver—in this case, the mortgagor.

Nicholson v. Western Loan & Bldg. Co., 60 F. (2d) 516 (C.C.A. 9th).

It conflicts with the rule that a receiver's rights and powers, as well as his representation, depend to a large extent upon the question of for whose benefit and in whose right he has been appointed.

Kane v. Roxy Theatres Corp., 63 F. (2d) 754 (C.C.A. 2d).

In this cause, the receiver having been appointed at the suit of a creditor other than the mortgagee, his adoption of the lease, years before the institution of foreclosure proceedings and the extension of the receivership thereto, should not affect the mortgagee's right to sue the lessee for acts and omissions impairing the value of the security.

4. It is further suggested that the omission of the courts below to render any opinion or assign any reasons for the summary dismissal of petitioner's suit constitutes a departure from the accepted and usual course of judicial proceedings, calling for an exercise of this court's power of supervision.

Cleveland, Cincinnati, Chicago & St. Louis Ry. Co. v. United States, 275 U. S. 404, at 414.

CONCLUSION

Wherefore, it is respectfully submitted that a writ of certiorari be granted to review the decision herein of the Circuit Court of Appeals for the Seventh Circuit.

IRVING L. SCHANZER,
Counsel for R. K. Japha, Petitioner.

August 5, 1943.